THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATION AND ENERGY

Investigation by the Department of Telecommunication and Energy on its own Motion into the Provision of Default Service	)	**D.T.E. 02-40**

INITIAL COMMENTS OF THE COMMONWEALTH OF MASSACHUSETTS DIVISION OF ENERGY RESOURCES

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I. Introduction

The Massachusetts Division of Energy Resources ("DOER") provides these comments in response to the June 21, 2002 order issued by the Massachusetts Department of Telecommunications and Energy ("Department" or "DTE") opening an investigation into provision of Default Service. The Department solicited public comments as part of an effort to ensure that:

> the manner in which Default Service is provided is compatible with the development of an efficient competitive market in Massachusetts…[and] that the benefits of a competitive market are available to all Massachusetts consumers at the end of the Standard Offer Service transition period.

The DOER commends the Department for continuing to provide timely oversight of the evolution of a competitive market for power in Massachusetts and welcomes this opportunity to presents its views on, and a proposal for, the provision of Default Service in a manner that is compatible with the development of an efficient competitive retail market.

The Department's initiative in undertaking the instant investigation is very timely. The terms of the 1997 Restructuring Act, St.1997, c. 164, as well as past initiatives by the Department and the Federal Energy Regulatory Commission, have put into place many of the essential ingredients for the successful development of an efficient competitive retail market: divestiture of the preponderance of the region's generating assets, creation of a workably competitive wholesale market, adoption of electronic data interchange and billing protocols, as well as provision of customer data to competitive suppliers. With these institutional structures in place, it is now time to develop Default Service beyond the early stages that were appropriate during the initial transformation of the Massachusetts market. The "Standard Offer" will end in March, 2005 and the Department needs to act with dispatch to ensure that the current structure of Default Service is not an impediment to the development of competitive options, especially for mass-market customers[1], and that it is an appropriate service to succeed Standard Offer Service.

In these comments, the DOER proposes modifications that can and should be made immediately to the manner in which Default Service is provided to mass-market customers to facilitate an increased range competitive options for these customers and to make Default Service into an appropriate successor to Standard Offer Service

These comments are organized as follows. Consistent with the Department's June 21 order, this introduction is followed by a short, 6 page Executive Summary. The body of the comments are divided into three sections: Background, the DOER Proposal, and the Conclusion. The questions posed in the Department's June 21 Order are addressed within the description of the DOER Proposal.

[1] As used herein the term "mass-market customers" refers to residential and small commercial customers. While different definitions of "small commercial" customers are allowed for purposes of the various distribution companies' class specific Default Service procurements and charges and the DOER is not now prepared to recommend a particular demarcation between small and medium commercial customers, the DOER does believe that a common definition can and should be adopted for purposes of Default Service and that it should be based on some measure of a given load's characteristics from the perspective of competitive power suppliers.

II. Executive Summary

Default Service, as currently purchased by distribution companies and priced for retail electricity customers, does not provide an optimal environment in which to develop competitive options for customers, especially mass-market customers. Nor does it provide the degree of protection against the vagaries of the wholesale market that is necessary for a product that will succeed Standard Offer Service and could become the power supply for more than half of the state's customers. While the slow pace at which competitive options have developed for mass-market customers is consistent with the experience in other jurisdictions that have opened their markets for power to retail competition, several years of experience with the current structure of Default service reveals several structural weaknesses. These weaknesses can and should be reduced or eliminated altogether to produce greater competitive options for customers and a service more appropriate for those who nevertheless choose to remain on it for extended periods of time.

A. Weaknesses in the Current Approach to Default Service

The manner in which Default Service is purchased often results in substantial changes in price from one procurement period to another because it delays the impact of significant changes in market conditions for six to twelve months at a time. It also can increase the volatility and instability of wholesale markets because it causes those markets to be more dependent than is advisable on short-term contracts for power. It also decreases a customer's readiness to turn to a competitive supplier for power by reinforcing the distribution company's role as power distributor, and keeping invisible the role of competitive suppliers in providing that power.

At the same time, the manner is which distribution companies price Default Service power also reveals several weaknesses. The exclusion of supply-related costs from the price of that supply results in an anti-competitive subsidy that prevents fair competition. Also, the six-month long "uniform price option" mutes the seasonal variation in power costs but provides only an illusion of meaningful price stability or certainty. Finally, the six-month duration of most Default Service supply contracts fail to provide both current and potential customers with information about what prices might be further into the future that would help them evaluate longer-term competitive offers.

B. Default Service Procurement

To address these weaknesses, DOER proposes that the Department require distribution companies to alter the manner in which they procure and price their Default service power supply. DOER recommends that the power supply for mass-market customers be procured through a regular program of two-year, partial requirements contracts, with a new contract for one-eighth of the company's Default Service demand commencing each quarter of the year. This approach would result in a portfolio of staggered contracts with prices for each month that could be averaged to provide a single monthly supply acquisition price for inclusion in the price charged to all mass-market Default Service customers. Contracts commencing less than two years prior to the end of the Standard Offer period would be written to absorb a proportionate (i.e. one-eighth) share of the company's demand for power to serve any customers shifting from Standard Offer to Default Service in March of 2005.

DOER submits that adoption of the recommended approach will spur increased availability of competitive options for mass-market customers. For example, customers would find competitive suppliers offering products with greater price stability (e.g. prices fixed for one or two years) or lower *ex ante* cost (e.g. real time or variable pricing). In addition, quarterly two-year contracts would provide mass-market customers with regularly updated information on forward Default Service prices with which they could evaluate competitive offerings. Finally, during the latter part of 2003 and throughout 2004, Standard Offer customers would be able to use that same forward price information to evaluate what they will pay for Default Service if they choose to remain on it when Standard Offer service ends.

For medium and large C&I customers, DOER recommends that the structure of Default Service be changed more modestly.[2] Most of these customers already have competitive alternatives to Default Service and generally do not require Default Service to provide the degree of price stability or forward price information that mass-market customers do. Therefore, procurement in six-month contracts should continue. However, these customers would benefit from the greater price stability provided by a limited version of the staggered, partial requirement contracts recommended for the mass-market. Specifically, DOER recommends that these procurements occur quarterly, each time for one-half of the company's power supply needs to serve large C&I customers on Default Service.

C. Default Service Pricing

DOER recommends the elimination of the requirement that distribution companies obtain power supplies for any customer class with a uniform price for periods of six months. Rather, DOER recommends that companies obtain bids with prices that remain uniform for no more than one month at a time. The DOER submits that this is consistent with the legislative requirement in G.L. c. 164, § 1B(d) ("all bids shall include payment options with rates that shall remain

[2] As used herein the term "medium and large C&I customers" refers to all customers who are not otherwise referred to as "mass-market customers." *See* n. 1, p. 2, *supra*.

uniform for periods of up to six months") and eliminates a price structure that mutes seasonal variation and provides more price certainty than is necessary.

To remove the current anti-competitive subsidy that excludes supply related-costs from Default Service prices, DOER recommends that the Department require distribution companies to include in those prices a surcharge to cover the avoidable costs associated with the provision of Default Service. Excluding these costs from the price of Default Service results in a subsidy likely to be greater than a competitive retailer's entire profit and perhaps much of a supplier's entire margin over wholesale supply acquisition costs. Removal of this anti-competitive subsidy will facilitate the development of competitive alternatives for customers. Requiring that distribution companies credit back to the distribution customers any revenues resulting from such a surcharge will avoid the need for any base rate review and eliminate the issue of double charging.

D. Locational Marginal Pricing

DOER urges the Department to require distribution companies to include any costs resulting from locational differences in Default Service power supply costs in the energy supply portion of the bill, rather than in distribution or transmission charges. This will cause the amounts in question to be subject to competition. DOER believes that distribution companies should allow their Default Service power suppliers or other competitive market participants to absorb any price risk associated with congestion management rather than attempting to manage congestion directly on their own. DOER further recommends that, for large commercial and industrial customers, the Department require distribution companies to differentiate Default Service energy supply prices according to the differences in the cost of providing power to the zone in which they are located. These customers have or can obtain the metering and other technologies needed to alter their consumption to avoid congestion charges and have competitive alternatives to Default Service that allow them to mitigate and shift the risk of congestion onto those suppliers. Moreover, requiring zonal Default Service pricing for these customers would negate a very real risk that those in high cost zones that are presently served by competitive suppliers would have an uneconomic incentive to return to Default Service.

Mass-market customers, on the other hand, currently do not have the metering or other technologies necessary to shift their congestion to avoid congestion costs. Nor do they have meaningful competitive alternatives that would enable them to shift congestion-related price risk to competitive suppliers. Nor is the financial consequence to them likely to be sufficient to provide an incentive to change their consumption toward that end. Therefore, DOER urges the Department to require that Default Service prices not be differentiated by zone for mass-market customers within a single service territory, at least until the end of the Standard Offer period in March 2005. Until the end of the Standard Offer period, mass-market customers should pay a price that is the average of the various zonal prices in the company's service territory.

E. Retail Services for Default Service Customers

Finally, DOER recommends that the Department require distribution companies to make several changes to their Default Service approach that would facilitate customer interaction with suppliers of Default Service. Companies should be required to inform their Default Service customers of the identity of the entities that provide their power supplies. Each Default Service supplier should be designated to serve as the "Power Supply Representative" for a portion of the distribution company's customers commensurate with the supplier's portion of the Default Service load. As a Power Supply Representative, a supplier will be required to operate a toll-free telephone facility to respond to customer inquiries regarding Default Service. Distribution companies would include the telephone number for a customer's Power Supply Representative with appropriate instructions on the customer's bill. The Department should further require that Default Service providers be suppliers licensed by the Department under G.L. c. 164, § 1F. This will provide the Department with the ability to insure compliance by the supplier with the requirements described here. The DOER submits that these modifications of the current approach to Default Service will increase customer awareness of the suppliers who actually provide their power and enable customers who care to do so to communicate with a designated competitive supplier. The modifications will impose minimal incremental burdens on distribution companies and Default Service suppliers.

All of the elements of the modifications recommended by the DOER are consistent with the requirements in G.L. c. 164, § 1B concerning Default Service and can be adopted by the Department without further legislative action.

III. Background

In the four years since Massachusetts created a retail market for electric power, the availability of competitive options for power supplies -- one hallmark of a vibrant retail market -- has varied substantially, both over time and over various customer groups. Large C&I customers have had the greatest range of options, although there were some earlier periods in which even these customers had few if any attractive competitive alternatives to either of the power services (Standard Offer and Default Service) provided by distribution companies. Attractive competitive options have and continue to be available to medium and large C&I customers.[3] As shown in Figure 1 below, for nearly a year, competitive suppliers have served a greater share of the state's

[3] See Attachment A for data on customer migration to competitive suppliers.

large C&I load than Default Service. As is shown in Figure 2 below, for the medium C&I load, competitive suppliers are now serving almost the same share as Default Service.

Figure 1: ***Large C&I Migration (kWh)***

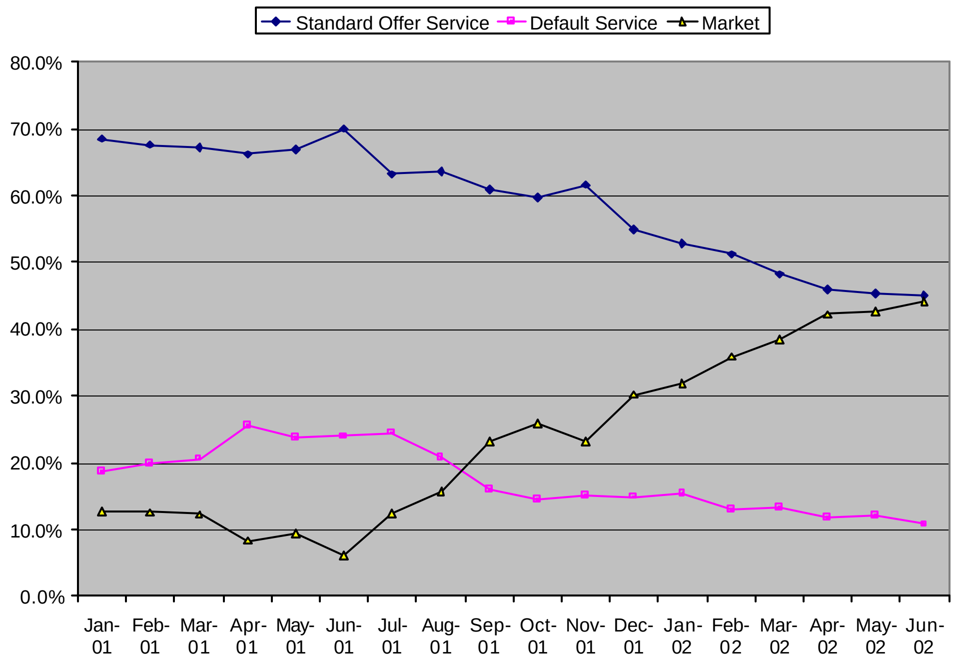
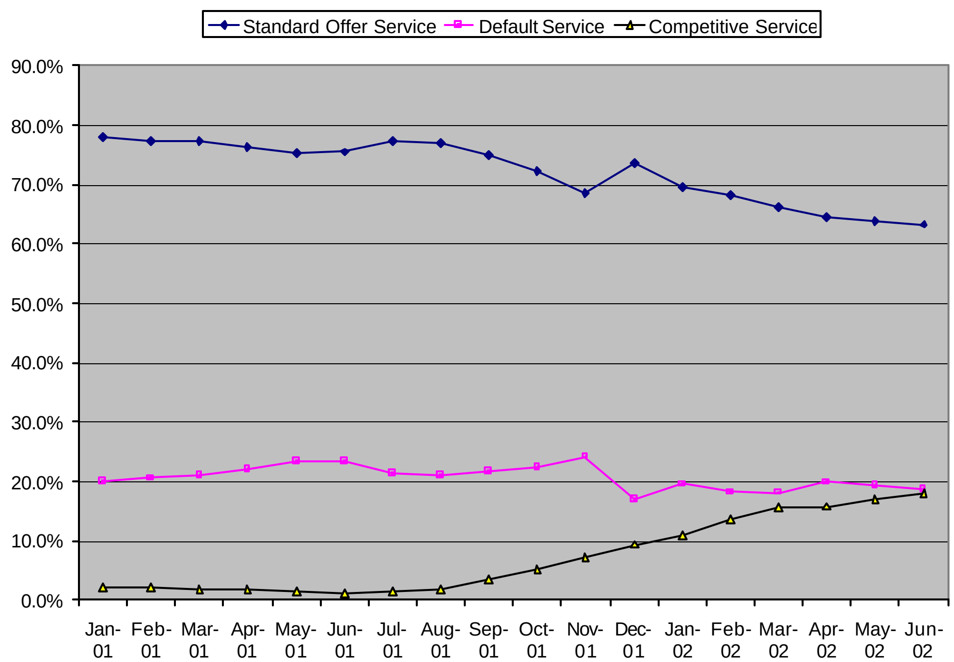


Figure 2: ***Medium C&I Migration (kWh)***



Mass-market customers, in contrast, have had few options and during many periods have had no competitive alternatives to utility service. As is shown in Figure 3 below, the percentage of residential load served by competitive suppliers has and continues to be in the low single digits.

Figure 3: *Residential Migration (kWh)*

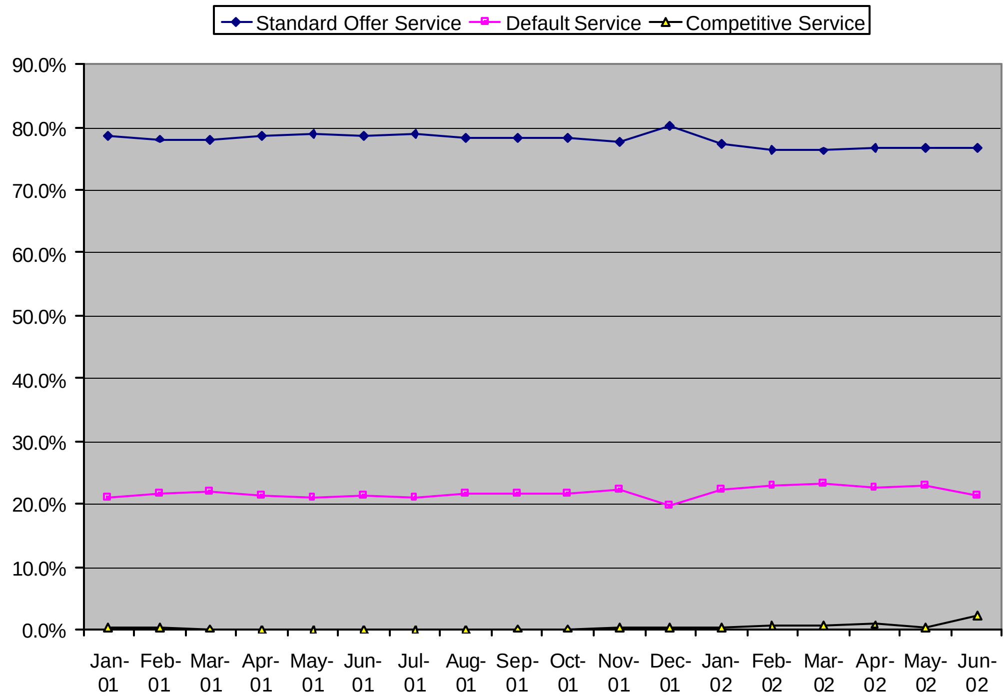
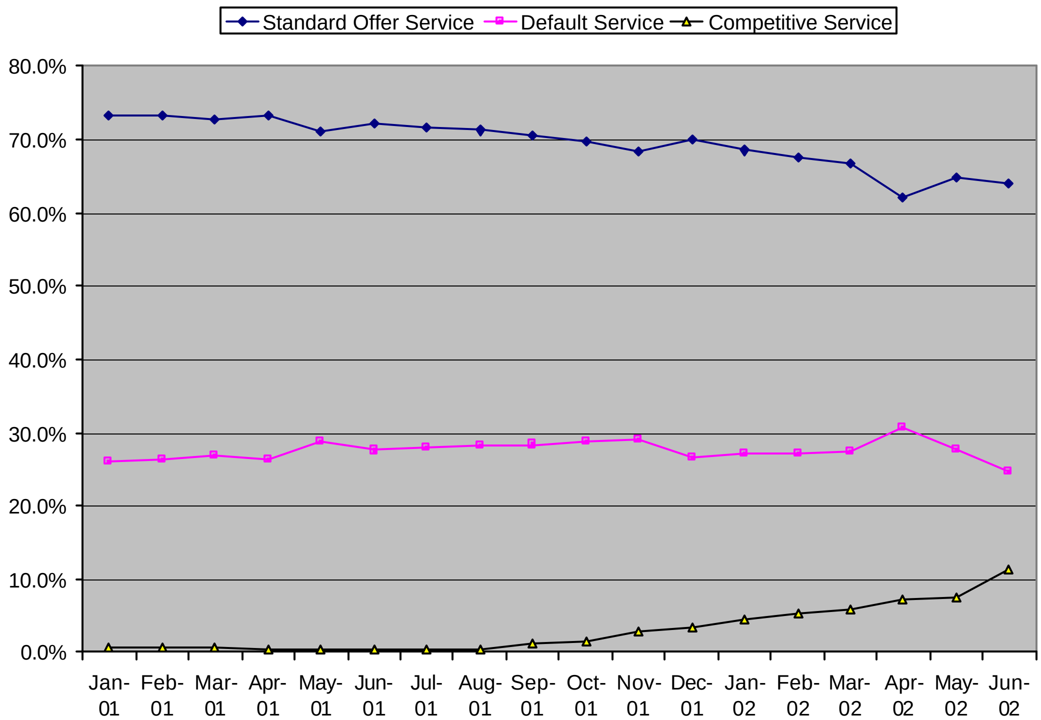


Figure 4 below shows that, putting aside a relatively recent surge, competitive suppliers have also not captured a meaningful share of the small C&I market.

While the Department is correct that relatively favorable "Standard Offer" pricing by some distribution companies has likely contributed to the slow development of a robust panoply of options for mass-market customers,[4] the DOER submits that the continued slow pace of

[4] Although the price of the Standard Offer Service provided by the Western Massachusetts Electric Company ("WMECo") is "market based" and has tended to be higher than that of the other distribution companies, the rate of penetration by competitive suppliers in the market for WMECo's customers has not been materially higher than that achieved in the service territories of the Commonwealth's other distribution companies. This is consistent with the fact that in the state of Maine, another state within the regional wholesale market, competitive options for mass-

Figure 4: ***Small C&I Migration (kWh)***



development of such options, in the face of the ever increasing market share of Default Service, demonstrates that Standard Offer pricing is not the only factor. A number of other factors contribute to the slow development of a competitive retail market. These include:

?? uncertainty associated with the resolution of various market-design issues confronted by suppliers;[5]

?? the absence, to date, of value-added features to differentiate the products of, and offset the marketing and customer service costs of, competitive suppliers;[6] and

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market customers have been slow to develop even though price of power service from Maine distribution companies is market-based.

[5] The uncertainty associated with various "market" issues has undoubtedly detracted from a stable environment that would encourage entry by suppliers into the mass-market for power sales. For example, DOER believes that uncertainty over the recognition of increased fuel costs in Standard Offer and Default Service rates as well as over the impact of potentially greater installed capacity ("ICAP") charges, reduced the availability and increased the price of competitive alternatives during 2000 and 2001. The current uncertainty over the impact on supply acquisition costs of the implementation of ISO-NE's "Standard Market Design" (particularly locational marginal pricing) ,as well as over the retail rate recognition that will be given to those costs, may be having a similar impact at this time.

?? the fact that potential power cost savings for mass-market customers are significantly lower in both absolute and proportional terms than those available to larger customers.[7]

Nevertheless, DOER submits that a significant contributing factor is the manner in which Default Service is presently procured and priced.

A. Structural Weaknesses in Default Service

Based upon its review of the available data and meetings with representatives of a wide range of interested market participants, the DOER submits that as presently procured and priced, Default Service is a significant impediment to the timely development of competitive options for mass-market customers.

Procurement Weaknesses

There are several weaknesses associated with the manner in which Default Service supply is purchased. First, the present approach to the procurement of Default Service power supplies makes the price of Default Service subject to significant and abrupt changes.[8] In most cases, distribution companies procure the total requirements for their expected Default Service load for a given upcoming period in a single procurement. This exposes customers to the risk of substantial price changes at the end of any single procurement period. With little advance warning, customers must absorb potentially significant disruptions in their monthly expense that can be occasioned by sudden jumps in prices. At the same time, delaying by six months or a

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6 With the exception of so-called “green” products and savings for participation in “on-line” payment options, price has been the basis for the product offerings to mass-market customers in the United States to date.

7 Not only are mass-marketmass-market customers’ total electric bills, by definition, smaller than those of most commercial and industrial customers, but the generation services portion of their bills tends to be a smaller proportion of their total bill. Thus, mass-market customers require a proportionately larger savings potential to attract migration and still offset a given level of customer acquisition costs.

8 The DOER is aware that the Department has approved variations from the use of a single, total requirements procurement as well as procurements for periods greater than six months.

year any reflection of power cost increases in the price of Default Service can lead to significant competitive disadvantages for competitive suppliers, effectively eliminating their ability to attract customers away from Default Service. This leads to a "boom and bust" environment in which competitive suppliers are reluctant to invest in marketing to customers and customers pay higher prices without any competitive offers to consider. A procurement methodology that muted abrupt changes but provided more current reflection of changing market conditions would be preferable for both Default Service customers and for competitive suppliers.

This weakness in the present approach to Default Service procurement, together with the reliance on six-month supply contracts, is particularly worrisome when considered in the context of the eminent end of the Standard Offer period. If continued, this structure would ignore the lessons learned from the recent experience in California which counsel against shifting such a large portion of the region's load onto a product for which the entire power supply is procured in periodic short-term, total requirements solicitations.

Second, the current structure of Default Service reinforces the affiliation of a customer with the distribution company, rather than reinforces the fact that, in a restructured market, customers should look to the market and to competitive suppliers for power supply service and information. Default Service is currently procured exclusively from wholesale suppliers, who sell in bulk to a few large volume buyers. This stunts the development of a robust retail market that would otherwise provide competitive options to mass-market customers[9] and frustrates the vision in the Restructuring Act of competitive options available to all customer classes, not just to large commercial and industrial customers. Competitive retail suppliers cannot serve mass-market customers unless Default Service suppliers are held to the same basic set of requirements:

[9] Large C&I customers buy in volumes that enable them to be served directly by retail suppliers who buy and deliver power to them in bulk.

e.g., DTE licensure; maintenance of a toll-free information hotline, etc.[10] Rather than perpetuate the illusion that it is within the distribution company's current role to provide information on and to address a particular customer's power needs, it would be preferable to structure Default Service procurements to establish relationships between customers and power "suppliers."

Pricing Weaknesses

There are also critical weaknesses in the manner in which the retail price of Default Service is determined. First, the price of Default Service does not reflect actual costs that are incurred by distribution companies in the provision of the service which are otherwise avoidable, e.*g.*, costs related to power supply procurements and the energy portion of the uncollectibles expense for default service customers. Second, the requirement that distribution companies provide an option for a price that remains uniform for six months obscures the seasonality in power prices and, thereby, creates an illusion of the price certainty that may be desired by customers but that is better supplied by competitive suppliers. Third, determining the price of Default Service on the basis of six-month total requirements procurements fails to provide any forward default service price information with which mass-market consumers could evaluate longer-term, competitive, fixed price options that might be available in exchange for a commitment to a competitive supplier for some "contract period."

These shortcomings of the current approach demand that modifications be made now to the pricing and procurement of Default Service to bring it into line with both market and public policy realities. The Department has recognized that the original vision of Default Service as serving a very small and episodic need for power during short breaks in service from competitive

[10] Later in these comments, the DOER recommends modifications to the current structure of Default Service that would result in greater parity in the requirements imposed on Default Service suppliers and competitive suppliers. See Section IV.E., *infra*, pp. 35-37.

suppliers does not reflect the current market realities, at least not for mass-market customers. There are currently few, if any, competitive options in the mass-market.[11] Default service is the source of power for almost every residential and small commercial customer that is not eligible for the Standard Offer. Barring a dramatic expansion of competitive options for mass-market customers between now and 2005, Default Service will soon be the source of power for most if not all of the Commonwealth's mass-market customers.

Yet, the current structure of Default Service is an impediment to the development of competitive options for mass-market consumers and it is not an appropriate service to succeed Standard Offer Service. Both of these problems need to be addressed promptly if the end of Standard Offer Service is to occur in an orderly fashion, one that is calculated to provide both confidence and competitive options to as many customers as possible.

The DOER submits that the proposal described in these comments provides a means by which the Department can address these two problems and in doing so remove most if not all of the weaknesses cited above. Moreover, it offers a means to do so in a timely manner that will allow its effectiveness to be evaluated and any necessary further refinements to be implemented prior to the end of the Standard Offer period.[12]

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[11] Until these circumstances change and mass-market consumers do, in fact, have a range of competitive pricing options available, "spot market" pricing for Default Service does not appear to be a viable alternative and pursuit of this pure pricing "ideal" for a distribution company power supply should not be allowed to sidetrack efforts to identify the best "possible" pricing regime with which to encourage the development of competitive options. Despite significant customer discontent over the abrupt changes in Default Service prices over the last two years, there are few competitive options available to mass-market customers to eliminate price volatility or to soften the impact of significant price discontinuities. Adoption of a "spot market" pricing policy would increase dramatically the volatility and the potential for Default Service price discontinuities. Since this may turn out to be the only option available to the majority of mass-market customers, such a policy does not appear to be a viable alternative to pursue in an effort to spur the development of competitive options.

[12] It is also important to observe that adoption of this proposal would not be inconsistent with or preclude future efforts to "privatize" the provision of Default Service.

IV. The DOER Proposal

The DOER proposes modifications that can and should be made immediately to the manner in which Default Service is now procured and priced, particularly for mass-market customers. These modifications are necessary to facilitate the expansion of the range of competitive power service options available to mass-market customers, to make Default Service into an appropriate successor to Standard Offer Service, to resume the unbundling of generation-related costs that is "a necessary first step to a competitive electricity market," *Electric Industry Restructuring*, D.P.U. 95-30, p. 38 (August 15, 1995), and to realign customer focus in regard to power supply issues from distribution companies to competitive suppliers. The proposed modifications respond to current market realities (the existence of different market barriers for different customer classes) and are calculated to both encourage competition and create a better service to succeed Standard Offer Service for mass-market customers. Moreover, because the adoption of all of these modifications is within the Department's existing authority, the DOER believes that these modifications can and should be implemented for effect by the start of 2003. Prompt adoption of these modifications will speed the pace of development of competitive options for electricity customers in the Commonwealth, and will provide adequate time for evaluation of their impact and potential further refinement prior the end of Standard Offer Service in 2005.[13]

[13] The DOER proposal does not require and the DOER does not advocate any reduction in the level of consumer protections prescribed by the Electric Restructuring Act or by the Department's rules and regulations. In particular, the DOER does not envision any relaxation in any of the disclosure, financial security, or other requirements that have been put into place to protect consumer interests.

A. The Department Should Modify Default Service To Reflect The Different Market Options And Default Services Needs Of Different Customer Classes

The current approach to the pricing and procurement of default serve should be modified to better reflect the market options available to and the Default Service requirements of different customer classes. The market for generation service to mass-market customers is separate and distinct from the market for medium and large business/institutional customers. This difference is reflected in the different range of competitive options available to the various customer classes. Medium and large C&I customers have available a wide range of pricing options available (from long-term, fixed prices to formula/index based variable prices to "block and spot" combinations of fixed and variable prices) while most mass-market customers have no options at all. The Department's approach to the pricing and procurement of Default Service should reflect these differences by requiring distribution companies to follow different pricing and procurement rules for separate classes of customers. While the current approach appears to work reasonably well for medium and large C&I customers, it precludes the development of competitive options for mass-market customers and fails to meet their reasonable requirements for a service to succeed Standard Offer. The DOER has formulated modifications to address the market options and the Default Service requirements of mass-market as well as large and medium C&I customers and it recommends that the Department adopt these modifications.

1. The Default Service Provided To Mass-market Customers Should Be Based On A Portfolio Of Staggered Medium-Term Contracts

To facilitate the development of competitive options for mass-market customers as well as to provide an appropriate structure for a Default Service offering to succeed Standard Offer, the DOER recommends the Department adopt an approach to Default Service for mass-market customers that is based on staggered, quarterly procurements of two-year, partial requirements contracts. There would be four procurements each year, each one resulting in a contract for one-eighth of the company's Default Service load. After two years there would be eight such contracts in effect. As each one expired, a new contract for one-eighth of the load for another two-year period would commence.[14] Each supplier would be responsible for the supply of one-eighth of the distribution company's Default Service load over the ensuing twenty-four month period from the start of the contract. Contracts that went beyond March, 2005, would absorb one-eighth of the load previously served under Standard Offer.[15]

This approach would result in a portfolio of contracts yielding prices for each month that would be averaged to determine the retail prices to be charged to mass-market customers. Although the price paid by Default Service customers would reflect the portfolio's average price, each winning supplier would be paid their individual monthly bid price. As is shown in Figure 5 below, this individual price would be given one-eighth weight in the determination of the monthly "portfolio" supply acquisition price during the period of their supply contract.[16]

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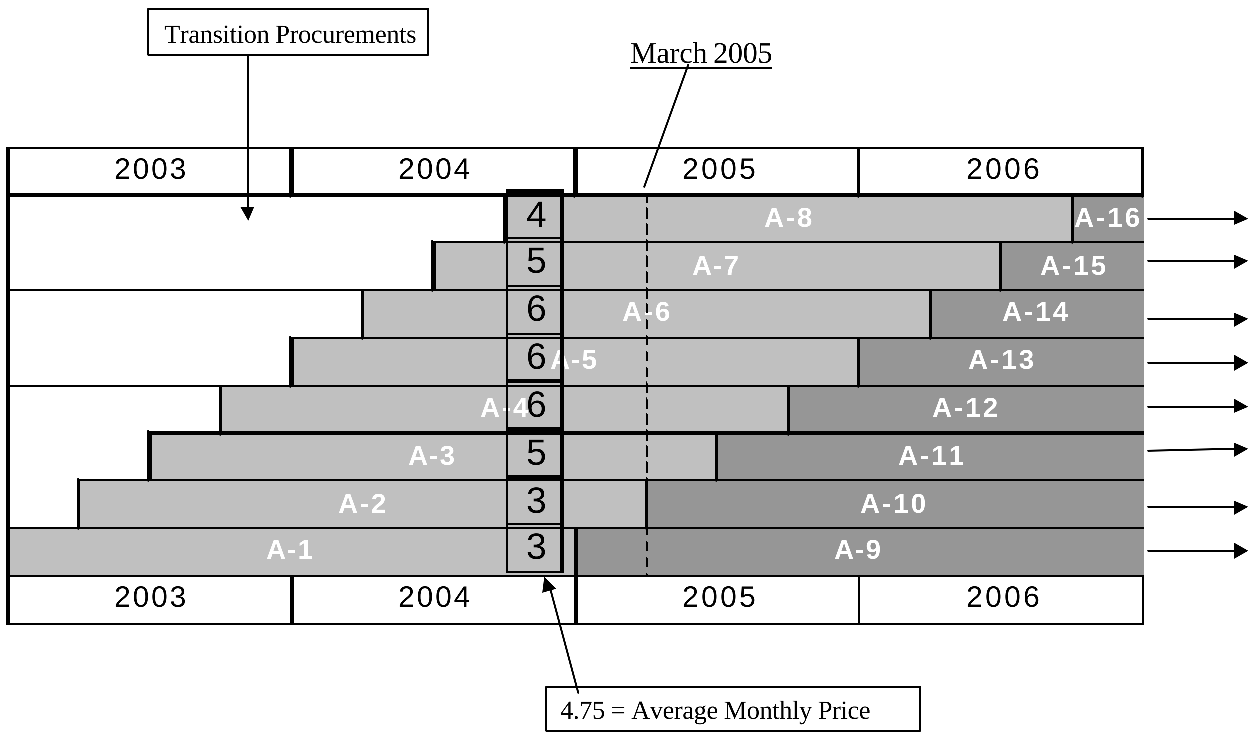
[14] As envisioned by the DOER, this staggered procurement process would be largely routine, *i.e.*, the timing and size of individual procurements would follow the same prescribed structure: every three months a new contract for one-eighth of the default service requirements would be solicited and procured. While there would be a need for some mechanism to provide the necessary degree of discretion to allow a distribution company to respond to extraordinary market circumstances (*e.g.*, a mechanism to seek to adjust a solicitation in light of recognized short-term market aberration resulting from events such as the September 11, 2001 attacks or the May 8, 2000 price spike), the process would otherwise be relatively mechanistic and proceed with pre-defined bid evaluation criteria. Distribution companies would adhere to this standardized procurement process (rather than attempting to "beat the market"), subject to some reasonableness review by the Department.

[15] Some program of transitional procurements would be necessary to transition from the current approach of a single total requirements contract to one with a portfolio of staggered partial requirements contracts. Assuming that the new program were to be implemented beginning on January 1, 2003, one possible transitional program would be to procure on the date of the expiration of a company's current supply a set of partial requirement contracts with terms varying from three months to two years (one-eighth for two years, one-half for one year, one-quarter for six months, and one-eighth for three months) that could form the basis for a twenty-one month program to build a staggered portfolio of eight twenty-four month contracts.

[16] As discussed *infra*, pp. 25-33, the DOER recommends that this average monthly supply acquisition price be increased by the amount of a distribution company surcharge equal to the avoidable administrative and uncollectibles costs associated with the provision of Default Service.

Figure 5: ***Default Service for Residential and Small C&I Customers***



<u>Staggered Procurement Process</u>:
•Quarterly procurements.
•2-year supply contracts for 1/8 of demand.
•Contracts A-3 and after absorb Standard Offer customers in March 2005.
•Default Service monthly price is average of all contract monthly prices.

The portfolio of two-year supply contracts would be "refreshed" each quarter with the expiration of one old two-year contract and the addition of a new one. With the start of each new contract, the monthly price paid by Default Service customers would be fixed for each of the next three months, that is, until the next oldest contract expired and a new one was commenced.

The DOER submits that adoption of the recommended approach will spur increased availability of competitive options for mass-market customers by creating opportunities for competitive suppliers to differentiate their products and by providing mass-market consumers with the forward default service pricing information necessary to evaluate competitive offerings.

In contrast to the current approach -- a contract of such short duration that it provides very little real price stability value and carries little or no price premium for the lack of any commitment for load to remain with the supplier -- the revised form of Default Service should create opportunities for suppliers to offer products differentiated to provide greater savings, price stability or price certainty. While the price of the revised version of Default Service for mass-market customers would be "reasonable" (i.e. customers would pay the lowest competitively bid price for a service that provides meaningful protection against short-term market instability and does not limit inward or outward migration), attractive competitive options could be made available to customers willing to commit to a particular supplier and/or to accept different protections against market instability over the same two year period. Customers willing to commit to a particular supplier for a fixed term should be able to obtain greater savings, price certainty and/or price stability. The greatest increase in *ex ante* savings would, presumably, be available to those willing to accept some form of real time pricing and to forego the price certainty/stability provided by the revised form of Default Service. Contrariwise, the smallest increase, if any, in *ex ante* savings would, presumably, be available to those selecting fixed price options for longer terms than the three months provided by the revised form of Default Service.[17]

In addition, with the receipt of each quarterly bid, customers would, in effect, receive updated, market-based "forecasts" of future pricing trends against which they could want to obtain protection by turning to the competitive market. This would provide mass-market consumers with information on forward Default Service prices against which they could compare

[17] Given that a uniform price option entails an allocation of the timing risk of any particular level of usage, the least possible *ex ante* savings would be available to those taking a uniform fixed price option for a period longer than three months. Of course, on an *ex post* basis, the realized savings could turn out to be greatest achieved if market prices increase and the customer's usage is even more concentrated in higher cost months than expected.

competitive offerings and evaluate the potential advantages and disadvantages of committing to a supplier for a particular contract period.

Finally, by requiring that each contract that extends beyond the end of the Standard Offer period absorb a proportionate (i.e. one-eighth) share of Standard Offer customers when that period ends, Standard Offer customers would be able to see what the price of Default Service might be when it succeeds Standard Offer. While information on those prices would be very incomplete during the first half of 2003 (only one or two contracts extending into the post Standard Offer period would be in place), it would grow increasingly more complete with each passing quarter and should provide more than enough information throughout 2004 to enable these customers to make informed decisions even prior to March 2005 as they consider moving to competitive offers.

While the recommended modification to the Department's existing approach to Default Service for mass-market customers may result in Default Service prices being somewhat less responsive to changing market conditions (the change embodied in any single new procurement would be given only one-eighth weight over the term of the contract, that embodied in any two successive procurements would be given only one quarter weight over the period in which they overlap, and so on), this reduced responsiveness must be balanced against the improved timeliness in reflecting market conditions provided by quarterly procurements compared to the present practice of semi-annual or annual procurements resulting in prices being "fixed" for periods of up to one year. Because of the overlapping contract terms and the averaging of prices in any given month, price changes experienced by mass-market customers under this proposal will tend to be more gradual than under the current approach. While market changes will impact retail prices paid by Default Service customers more closely in time to when they actually occur, the full impact of such changes will be muted. Improved timeliness combined with muted influence will provide mass-market customers with the price signals they need to consider moving off of Default Service without unduly punishing them if they choose not to do so.

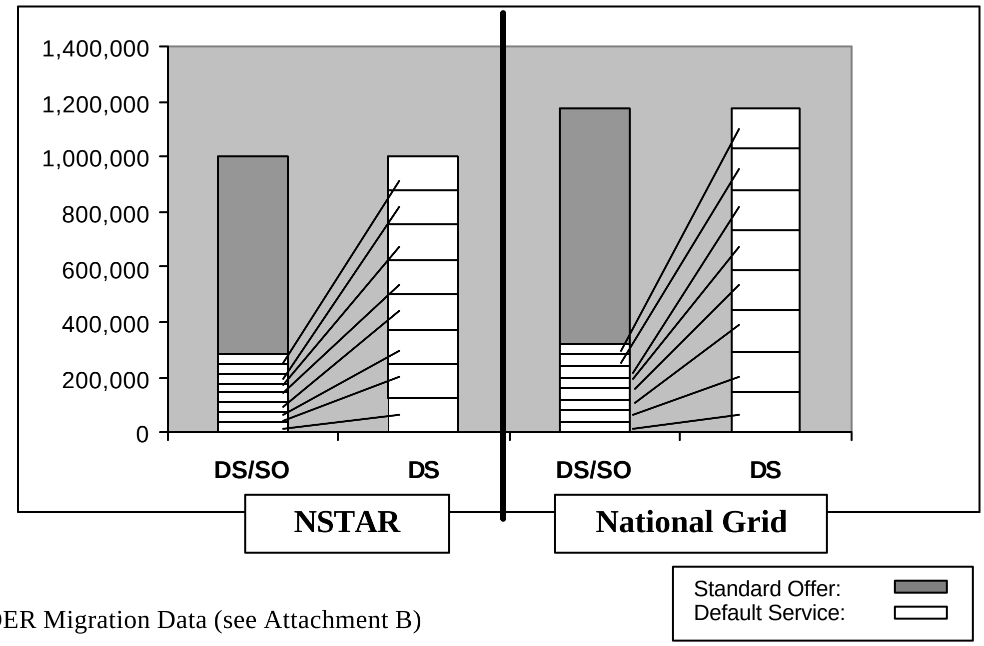
It should be emphasized that while the particular combination of two year contract length and quarterly procurement structure recommended here is not unique in providing increased price stability and forward pricing information, a number of distinct considerations recommend this structure. First, unlike supply contracts for shorter terms, a twenty-four month fixed price supply contract is of sufficient length to span and "smooth" the impact of short-term fuel price and capacity shortages.[18] Second, quarterly price updating has the virtue of matching the frequency of price changes with which consumers were familiar prior to restructuring (e.g., fuel clause adjustments). Third, a one-eighth impact on the Default Service price from any single procurement is significant, but not overwhelming. Moreover, solicitations for one-eighth of each distribution company's mass-market customer Default Service loads should result in reasonable sized procurements.

Moreover, solicitations for one-eighth of each distribution company's mass-market customer Default Service loads should result in reasonable sized procurements. While some may complain that a quarterly procurement seeking one-eighth partial requirements for Default Service may not be optimal for existing loads, it must be emphasized that the DOER proposal is made in express contemplation of providing a bridge to the post-Standard Offer period when mass-market Default Service loads will likely expand by orders of magnitude. As is shown in Figure 6 below, barring a sea change in the rate of migration to competitive supplies, the size of

[18] Although supply contacts with longer terms than twenty-four months are possible and would also span and smooth short-term market events, twenty-four month supply contracts appear to be near the maximum duration for which there is a robust and liquid wholesale supply market at the present time.

the procurements for the Commonwealth's two largest distribution companies in the post-Standard Offer period should be more than sufficient to attract interest and minimize costs. The fact that this approach may need to be adjusted for the Commonwealth's two smaller distribution companies (Western Massachusetts Electric Company and Fitchburg Gas & Electric Light Company) should not prevent the Department from concluding that it is an appropriate and workable solution for ninety percent of the state's Default Service loads.[19]

Figure 6: ***Default Service Procurements in Blocks***



Source: DOER Migration Data (see Attachment B)

The figure shows 1) the number of mass-market customers on Default Service and Standard Offer as of June 2002, and 2) the number of mass-market customers that would be on Default Service if Standard Offer had ended as of the end of June 2002. In the first case, NSTAR's current group of mass-market Default Service customers would divide equally into eight groups of roughly 36,000 customers each, while Massachusetts Electric's current group would divide equally into eight groups of roughly 40,000 customers each. In the second case, the much larger group of mass-market Defaults Service customers would divide into groups of roughly 113,000 for NSTAR and 133,000 for Massachusetts Electric.

[19] To the extent that the Department concludes that some modification is necessary to reflect the different circumstances of these smaller companies, the DOER recommends that the quarterly element of the proposed structure, not the two-year contract element, be modified. Assuming that the size of the Default Service loads would be efficiently served through four one-quarter, partial requirements solicitations rather than eight, one-eighth partial requirements solicitations, the DOER believes that both the development of competitive options and consumer interests in price stability would be better served by four semi-annual procurements of two year contracts than by four quarterly procurements of one-year contracts.

2. The Default Service Provided To Large and Medium Customers Should Be Based On A Portfolio Of Staggered Short-Term Contracts

The DOER recommends that the structure of Default Service for medium and large C&I customers be modestly changed. It is evident from the market share data presented above as well as the Department's own observations concerning the market for large and medium C&I customers, that the current structure of pricing and procurement of Default Service does not appear to create a significant impediment to the development of a robust competitive market for these customers. With larger potential sales volumes, these customers are the most attractive near-term sales candidates for competitive suppliers and their greater buying sophistication better allows them to perceive and evaluate the potential benefits of competitive options. In these circumstances, then, the DOER proposes that the current approach of employing six-month contracts be retained for large and medium C&I customers, but that the procurement be modified to employ two, partial-requirements solicitations, staggered quarterly to improve the reflection of changing market conditions and more timely price changes. This would result in quarterly procurements of partial requirements contracts for one-half of a distribution company's medium and large C&I Default Service load and a monthly supply price for such customers equal to the average of the two bid prices for each month. As modified, the Default Service provided to medium and large C&I customers would provide more timely reflection of changing market conditions than the current approach and it would reduce its vulnerability to the vagaries of market conditions at the time of any single procurement.

B. The Department Should Eliminate The Requirement For A Uniform Six-Month Default Service Price Option for All Customers

The DOER recommends that Default Service be provided with monthly prices. The Department should eliminate the requirement that distribution companies obtain bids for uniform prices for periods greater than one month. As the Department has recognized, monthly pricing "most effectively accomplishes" the goal of pricing Default Service at market rates and "[m]asking of seasonal price variability is an avoidance of reality that serves no one." April 21, 2001 Letter from Commissioners re: *MECo's Default Service Pricing*. Moreover, a requirement that a six-month uniform price option be made available by distribution companies may actually harm consumers by creating little more than an illusion of real price stability, while dampening their motivation to seek meaningful price certainty from the competitive market. Customers seeking uniform payments to facilitate their budgeting can continue to avail themselves of distribution company budget billing programs. As the Department has explained, these programs accomplish results that are similar to a uniform price but without clashing with market pricing principles. April 21, 2001 Letter from Commissioners re: *MECo's Default Service Pricing.*

The DOER submits that the significant increase in future price information and price predictability provided to customers under its proposal, together with the continued availability of a budget billing option, increases the tools available to and, therefore, the ability of mass-market customers to manage and budget their electric bills. This increases the value of Default Service for such customers by far more than any value provided by the uniform price option.

Although the Department has in the past expressed a view that the language in G.L. c. 164, § 1B(d) should be read to require "that a fixed-price, six-month Default Service option be available to all customers," it has acknowledged that another interpretation of the relevant "up to" language is to permit fixed price options for any period up to but not exceeding six months. *Default Service Pricing and Procurement*, D.T.E. 99-60-B, pp. 6-7, n. 8 (2000) and accompanying text. The DOER submits that the latter interpretation is more consistent with the legislative language in G.L. c. 164, § 1B(d). This interpretation also accords the same degree of discretion to the Department in regard to the design of Default Service that is granted to the Department in other portions of the 1997 Restructuring Act. *See e.g.:* G.L. c. 164, §§ 1B(e) (administration of rate cap), 1C (affiliate standards of conduct), and 1F(7) (service quality standards).[20]

C. The Department Should Resume The Unbundling Of Avoidable Generation Related Costs For All Classes of Customers

Consistent with its stated intention to revisit its earlier decision to refrain from requiring distribution companies to include administrative and "bad debt" costs in the price of Default Service, *Opening Order*, pp. 5-6, the Department should take this opportunity to resume the unbundling of the avoidable generation related costs which it long-ago identified as "a necessary first step to a competitive electricity market." *Electric Industry Restructuring*, D.P.U. 95-30, p. 38 (August 15, 1995). In particular, DOER submits that the Department should require distribution companies to include within the price of Default Service an amount or surcharge to cover the avoidable costs associated with the provision of Default Service.[21] Anything less would maintain an anti-competitive barrier to the development of competitive alternatives to

[20] To the extent that the Department feels compelled to require an option for a uniform price for a period greater than one month in duration, the DOER urges the Department to limit the uniform price option to three months. Consumers were familiar with and accepted such periodic price changes in the pre-restructuring world, *i.e.*, the former program of quarterly fuel and purchased power cost adjustments that was authorized under G.L. c. 164, § 94G. A quarterly fixed price mechanism combined with quarterly procurements, as recommended above, would avoid the need to provide for the reconciliation procedures and inevitable pricing revisions that would be required to administer a uniform six month price (in the context of quarterly procurements). Moreover, limiting the uniform pricing option to three months provides for more timely reflection of changing market conditions in the prices charged in subsequent months as well as a more accurate representation of the seasonal nature of generation costs. The Department could require uniform quarterly periods that correspond to the four seasons -- spring (March, April and May); summer (June, July and August), fall (September, October and November); and winter (December, January and February) -- and, so long as individual companies did not adhere to the same solicitation schedule, the procurements would not need to be unduly concentrated in time.

[21] In addition to the power supply component of a distribution company's uncollectibles expense for Default Service customers, "avoidable costs" would include, but not necessarily be limited to, the personnel and overhead costs of power supply procurements.

Default Service in the form of an explicit cross-subsidy of indisputable costs incurred in the provision of, but not reflected in the price of, Default Service.[22]

In D.T.E. 99-60-B, the Department refrained from requiring distribution companies to include within the price of Default Service the avoidable administrative and bad debt costs associated with that service on the grounds that the magnitude of such costs was small in comparison to the cost of Default Service power supply costs and did not "warrant" the associated additional administrative burden. *Default Service*, D.T.E. 99-60-B, pp. 16-19 (June 30, 2000). The Department took this action notwithstanding its initial disposition in favor of such a pricing rule and expressed acknowledgement that "the inclusion of administrative costs in the price of Default Service sends the right price signal to customers." *Id.* As is explained below, the DOER submits that the Department's initial conclusion regarding unbundling -- "Default Service prices must take into account the full costs of providing the service in order to encourage the development of robust competitive retail markets," D.T.E. 99-60-A, p. 10 (May 10, 2000) -- was correct and that, based on a fuller examination of relevant circumstances, the Department should now revisit its decision in D.P.U. 99-60-B and then resume its earlier effort to fully unbundle the costs of providing Default Service. The stated reasons for the decision in D.T.E. 99-60-B are based upon a misapprehension of the relevant facts and are inconsistent with the long-standing rate principle that "cost responsibility should follow cost incurrence."

It is an axiom of cost of service ratemaking that cost responsibility should follow cost causation. As the Department has explained,

[22] From the perspective of creating the necessary level playing field on which consumers may enjoy the benefit of having a choice among power supply providers, eliminating such cross-subsidies is no less important than providing that all retail electricity suppliers selling electricity to end use customers in Massachusetts (including distribution companies and competitive suppliers) are subject to the Commonwealth's renewable resources portfolio requirements. *See* 225 C.M.R. 14.02.

> economic efficiency in rate structure means that it is cost-based, reflecting the cost to society of the consumption of resources to produce the utility service. Fairness means that, except in special cases supported by clearly articulated reasons and explicit decision by the Department, the rate structure should require no class of customers to pay more than the costs of serving that class.

New England Telephone and Telegraph Company, D.P.U. 86-33-G, p. 382 (1989). Thus, in addition to allocating among customer classes and individual customers responsibility for the costs of particular assets used in the provision of utility service, the Department's long-established practice is to make appropriate allocations of administrative costs, in general, and bad debt costs, in particular, to individual rate classes as well as to unbundled competitive or "below the line" products. *See New England Telephone and Telegraph Company*, D.P.U. 86-33-C, pp. 74-75 (1987)("no question" regarding need to allocate directly to individual classes responsibility for that class' uncollectibles); *Massachusetts Electric Company*, D.P.U. 89-194/195, pp. 48-51 (1990)(direct allocation of uncollectibles and a relative revenue allocation of other administrative expense to water heater rental program).

In other environments where the Department has acted to accommodate/allow the development of competitive options, it has adhered to this fundamental principle to unbundle rates to achieve economically efficient pricing. *See e.g.: Intra-LATA Competition*, D.P.U. 1731 (1985); *Boston Gas Company*, D.P.U. 93-60, pp. 281 (1993)(approving the inclusion in CGAC of test-year levels of Account 813 gas supply acquisition costs -- salaries and benefits of gas supply acquisition personnel); *Boston Gas Company*, D.P.U. 96-50 (Phase I), p. 72 (1996), *modified on remand*, D.P.U. 96-50-D (2001), *rev'd on other grounds* 436 Mass 233 (2002) (agreeing with DOER and Attorney General that allocating bad debt between base rates and the CGAC is consistent with the Department's goal of rate unbundling"). As the Department has explained, "in an unbundled competitive market environment, the ultimate goal should be to provide alternative services that reflect market prices so that customers can make efficient choices." *Boston Gas Company*, D.P.U. 93-60, *supra*, p. 413.

From its earliest efforts to restructure the electric industry, the Department has recognized that adherence to this principle of economic pricing would be critical to realizing the benefits of a competitive retail market and that it would require a careful unbundling of the rates for those services for which competitive alternatives were to be made available. The second of the Department's five "transition principles" for restructuring the electric industry was that "[r]ates … should be unbundled as soon as possible" because "unbundling of rates is critical to provide both customers and competitors with the information they need to make decisions in a more competitive environment." *Electric Industry Restructuring*, D.T.E. 95-30, p. 29. As the Department explained,

> For customer choice to spur competition in a market, customers must be able to compare the prices and terms of the various products and services that are available. This requires the identification of distinct products and services (i.e., unbundling) and the ready availability of clear and transparent prices and current market information (i.e., a spot market). Thus, electric companies must separate their services and unbundle the rates for the services that they provide.

Id., pp. 18-19.

In light of this clear and long-standing recognition by the Department of the critical importance of establishing economically correct rates in the development of an efficient competitive market, the continuing value of the decision in D.T.E. 99-60-B to abandon a requirement for the unbundling of administrative and bad debt costs associated with the provision of Default Service is dependent upon the continuing validity of the factual conclusions upon which it was premised: (1) that such costs are not significant compared to the price of Default Service power supplies prices; (2) that including such costs in the price of Default Service could result in a reallocation of costs among rate classes; and, (3) that the administrative burden of including such costs in the price of Default Service was greater than the likely impact on the price of Default Service. *Default Service*, D.P.U. 99-60-B, p. 19 (2000). For the reasons set forth below, however, the DOER submits that when viewed in the more complete context afforded by the instant inquiry, it is clear that those earlier factual conclusions should be reconsidered. Therefore, the Department should resume the pursuit of an efficient competitive market through the elimination of barriers to entry created by pricing rules that do not require the recognition of uncontroverted avoidable costs that are incurred by distribution companies in the provision of Default Service.

First, while the Department may have been correct that the level of the administrative and bad debt costs incurred by distribution companies in connection with the provision of Default Service is small in comparison to the price paid by consumers for Default Service power, that is not the relevant comparison for purposes of determining whether continuation of the uncontroverted cross-subsidy would create a significant impediment to the development of an efficient competitive market and the expansion of the options available to customers. Rather, the relevant comparison is of these costs to a retailer's margin over wholesale power costs. Based on the earlier representations by distribution companies regarding the administrative costs incurred to supply Default Service, D.P.U. 99-60-B, p. 17 (between 0.2 to 0.4 mils per kwh), as well as reasonable approximations of the bad debt costs associated with providing Default Service to mass-market customers (between 0.6 and 1.0 mils per kwh),[23] it appears clear that these costs are in the range of 1 mil per kwh or about two percent of a 5¢/kwh Default Service price. Assuming

[23] For example, taking the total bad debt expense reported by Boston Edison for 2000, $13,038,285, and assigning sixty percent of that amount or $7,822,971 to sales to residential and small commercial customers (an assignment that is consistent with the cost of service study submitted in conjunction with Edison's restructuring plan), the average residential and small commercial bad debt expense is 2 mils/kWh, which would correspond to a Default Service expense about 0.8 mils/kWh if the energy service component was forty percent of the average residential and small commercial bill and the Default Service uncollectibles experience is the same as that for Standard Offer Service.

a total retail margin over wholesale supply costs of ten percent, or less than 5 mils, excluding these costs from the price of Default Service results in a subsidy likely to be greater than a competitive retailer's entire profit and perhaps much of a supplier's entire margin over wholesale supply acquisition costs. Viewed from this vantage point, it is plain that the Department's earlier conclusion that these costs are too small to matter is simply incorrect.

Second, although the Department may have been correct to observe that "inclusion of these costs as a uniform adder would result in a re-allocation of costs among rate classes," it is plain that that fact alone does not require the continued maintenance of an unreasonable and unnecessary barrier to entry into the market for power until such time as all of the distribution companies' base rates are reexamined and reset to eliminate these costs. A base rate case may be the most comprehensive mechanism to eliminate cross-subsidies from distribution rates as well as to allocate costs between fixed and variable charges,[24] but it is not the only way. In D.T.E. 99-60, Massachusetts Electric Company, Western Massachusetts Electric Company, the Attorney General, and AllEnergy all acknowledged that it would be appropriate to recognize such costs through a distribution company adder or surcharge with a credit back of the resulting revenues to all distribution customers. *See Default Service*, D.T.E. 99-60-B, pp. 18-19; *Initial Comments of the Attorney General*, (July 14, 1999). This would eliminate both the barrier to the development of competitive options as well as any potential double recovery by the distribution companies. *Id.* Moreover, notwithstanding earlier reservations that employing such an approach could result in a reallocation of bad debt costs, *Default Service*, D.T.E. 99-60-B, p. 19, the mechanism

[24] The DOER recognizes that some portion of these costs is more appropriately collected through a fixed rather than a usage-based charge and that such treatment cannot be accomplished under the proposal made here. Notwithstanding this acknowledgment, however, the DOER submits that the public interest would be better served by an approach that gave timely, though somewhat imprecise, recognition to these costs of providing Default Service than it would be by continuation of the current approach that ignores those uncontroverted costs altogether.

proposed here could be class specific and could eliminate any inter-class cost re-allocation concerns as has been done in the case of the various adjustment clauses in place for gas distribution companies, *cf. Bay State Gas Company*, D.P.U. 95-104, p. 5, n. 5 (1995)(class specific cost of gas adjustment); *Fitchburg Gas & Electric Light Company*, D.P.U. 98-51, pp. 151-154 (1998)("avoids interclass subsidization"), as well as in the case of the newly approved inter-class Transition Charge revenue reconciliation mechanism adopted for Boston Edison, *Boston Edison Company*, D.T.E. 00-82 (2001)(Phase II).

D. The Department Should Require The Price Of Default Service Include The Effects Of Locational Marginal Pricing

The DOER urges the Department to require that any costs resulting from locational differences in wholesale power supply costs be flowed through to Default Service customers on the energy supply portion of the bill, rather than through distribution or transmission charges.[25] Such costs are properly considered to be related to the provision of generation services and, thus, as part of an appropriate unbundled rate structure, should be reflected within the rates for power service. Consistent with its other recommendations that the structure of Default Service should reflect the difference in the current market opportunities and realities for medium and large C&I customers as compared to those of mass-market customers, the DOER recommends different approaches to the manner in which these costs are flowed through to these different customer groups. In particular, for the reasons set forth below, the DOER submits that the Department should require that distribution companies implement zonal Default Service pricing for medium

[25] In 2003, at the direction of the Federal Energy Regulatory Commission, ISO-NE will determine hourly clearing prices for wholesale power for each hour of the year in nine different zones around New England. Massachusetts has three of those zones: northeastern Massachusetts (including Boston and roughly bounded by Rt. 495), southeastern Massachusetts (including Cape Cod), and western Massachusetts (beyond Rt. 495).

and large C&I customers and average pricing for mass-market customers.[26] This approach should provide the appropriate balance between the competing goals of maximum economic efficiency and practicality at least until the end of the Standard Offer period.[27]

Locational pricing has been adopted to eliminate cross-subsidies between transmission zones and to provide price signals calculated to reduce the current level of "congestion" or "uplift" costs.[28] It will provide useful price information to all market participants indicating where new transmission capacity is needed, where new power plants should be located and where demand reductions by customers would be most effective. The DOER has been a strong supporter of Locational Marginal Pricing in the wholesale electricity markets.[29]

Requiring that the incremental costs resulting from locational pricing be included in the price of Default Service will make the amounts in question subject to management by competitive suppliers, who are best equipped by experience and incentive structure to identify, evaluate, price, and deliver risk management for congestion. Competition among bidders to

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[26] Distribution company service territories do not necessarily align with Massachusetts' three LMP zones. The service territories of Cambridge Electric Light Company, Commonwealth Electric Company, Fitchburg Gas and Electric Light Company, and Western Massachussetts Company are each located within single LMP zones. The service territories of Boston Edison Company and Massachusetts Electric Company, however, each extend beyond single zones. Most of NStar's Boston Edison territory is located within the Northeast Massachusetts Area (NEMA), but a small portion is located within the Southeast Massachusetts Area (SEMA). Massachusetts Electric Company's service territory is distributed across three zones: NEMA, SEMA and the Central/Western Massachusetts Area.

[27] The DOER further urges the Department to require the distribution companies to treat zonal differences in Standard Offer power costs in the same manner as that recommended for Default Service, at least to the extent that it is possible. Otherwise, as Standard Offer prices get higher through 2005, a lack of zonal differences may result in adverse selection among large and medium C&I Standard Offer customers by competitive suppliers.

[28] The optimal outcome is not necessarily a system without congestion. There may well be instances where the costs to change consumption patterns, locate generation or upgrade transmission exceed, on a net present value basis, the congestion cost savings achieved over the life of those investments. In these cases, tolerating the congestion is the economic outcome. Nevertheless, it is very likely that a system such as the current New England bulk power grid is far from efficient in its management of congestion since customers, suppliers, generation developers and transmission builders have never before had direct financial incentives to take action to reduce congestion.

[29] Most recently the DOER has expressed its support for Locational Marginal Pricing in the Federal Energy Regulatory Commission proceeding addressing Electricity Market Design and Structure (RM01-12-000).

provide Default Service should insure that those customers receive the benefit of this risk management capability at the lowest cost, consistent with the workings of a fully competitive wholesale market.[30]

The most efficient policy, from a purely economic standpoint, might be to require zonal pricing of Default Service for all customers. It would maintain greater equality between Default Service prices paid by retail customers and the prices of retail competitors. Those suppliers will incur power costs on a zonal basis but are not likely to be able to average those costs over zones and, therefore, would otherwise tend to focus on customers in low cost rather than high cost zones. However, such a policy needs to be tempered in light of several practical realities that suggest it be modified, at least temporarily, for mass-market customers. Commercial and industrial customers, especially those with hourly meters, can take steps to avoid consumption during congested periods. Moreover, they are in a position to receive competitive offers that would hedge this congestion price risk in a manner customized to fit their circumstance and consumption pattern . Mass-market customers, on the other hand, lack hourly meters and the technology that would allow them to shift significant consumption to non-congested times. They are less likely to be offered competitive alternatives to Default Service in the near term (and no one would suggest that differentiating locational prices would, by itself, change that). And the impact of congestion on their monthly bill is not likely to be large enough to motivate significant investment in demand response technologies. They therefore are likely to have little incentive and few opportunities to mitigate the impact of locational differences in pricing.

[30] The DOER urges the Department to discourage distribution companies from attempting to manage the congestion-related risks specific to Default Service power supplies. It would put customers at risk of paying for any failures to effectively manage the risk. There is no need for this form of self-insurance by customers when competitive suppliers are capable of handling these risks and equipped to do so.

The DOER therefore believes that, temporarily, it is prudent and responsible to average the prices paid by mass-market customers across a service territory. Nevertheless, before the end of the Standard Offer period, the Department should revisit this policy. By that time the consequential near-term changes in consumption patterns by medium and large C&I customers may have more efficiently distributed and reduced congestion across the region. Mass-market customers may be less exposed to the risk of a larger than necessary level of congestion. Competitive suppliers may well have begun to make progress in the mass-market and it would then be appropriate to reconsider the optimal treatment of zonal price differences for mass-market customers.

E. The Department Should Modify Default Service To Reorient Consumers Toward Competitive Suppliers In Regard To Their Power Supplies

The DOER recommends that the Department modify the existing Default Service structure to provide reinforcement for the necessary shift in customer focus concerning the price and terms of their power supply from distribution companies to competitive suppliers. While many customers today do not have attractive competitive service options, the industry structure envisioned by the Department and embodied by the terms of the 1997 Restructuring Act is one in which consumers will look to the market rather than their local distribution company to address the price, terms and conditions under which they purchase power. With the Standard Offer transition period ending in 2005, the DOER believes that it is necessary for the Department to take reasonable and appropriate steps at this time to reinforce for mass-market customers the fact that their distribution companies are no longer primary suppliers of power. These steps should be taken to ensure that mass-market consumers will be prepared to search for and evaluate competitive options that may become available.

In particular, the DOER recommends that the Department require distribution companies to:

1. inform their Default Service customers of the identity of the entities that provide their power supplies;

2. designate each of its Default Service suppliers to serve as the "Power Supply Representative" for a portion of the distribution company's customers commensurate with the supplier's portion of the Default Service load;

3. require each Default Service power supplier to operate a toll-free telephone facility to respond to inquiries regarding Default Service from those customers for whom it has been designated Power Supply Representative (Distribution companies would include the telephone number for a customer's Power Supply Representative with appropriate instructions on the customer's bill);

4. require Default Service providers to be "suppliers" licensed by the Department under G.L. c. 164, § 1F.[31]

The proposed modifications should reduce customer confusion over the actual roles played by different entities in the restructured market. They would bring Default Service customers into a more appropriate alignment with competitive suppliers in regard to their power service (as compared to the current approach in which there is no connection whatsoever between those customers and the actual suppliers of their power). As modified, Default Service would better reflect the reduced role of distribution companies in a restructured marketplace and better "accommodate retail access to generation services and choice of suppliers by retail customers." G.L. c. 164, § 1A(a). Moreover, the proposed modifications do not result in any

[31] In addition to being consistent with the requirement in G.L. c. 164, § 1B(d) that only a "department approved provider" can bid to supply Default Service power, a licensure requirement will ensure adequate authority for the Department to regulate and supervise the conduct of Default Service suppliers in carrying out their customer information responsibilities. This is particularly important in regard to the oversight necessary to ensure proper operating practices regarding the handling of each provider's call center. For example, to prevent consumer and competitive abuses, the Department could require the use of approved scripts for responding to complaints regarding prices levels or inquiries regarding competitive alternatives to Default Service. The DOER's proposal can be approved without sacrificing the necessary customer protections prescribed by the Electric Restructuring Act.

formal change in a customer's supplier of generation services, thereby, avoiding the "affirmative choice" issues that could be raised in regard to more ambitious proposals.

The DOER submits that these modifications would impose minimal incremental burdens on distribution companies, their customers and Default Service suppliers while at the same time they would maximize the degree to which the structural change in the industry is brought into sharp relief for customers. The modifications do not entail the incurrence of any materials costs and, thus, should not result in any material increase in the Default Service administrative costs of distribution companies or in the cost to consumers for Default Service.

F. The Modifications Proposed By DOER Are Consistent With Existing Statutory Terms Concerning Default Service And May Be Adopted Without Further Legislative Action

All of the elements of the modifications recommended DOER are consistent with the requirements in G.L. c. 164, § 1B concerning Default Service and can be adopted by the Department without further legislative action. The Department has already approved the procurement of Default Service power supplies through staggered partial requirements contracts as well as fixing the Default Service rate at the average of the prices bid in the various contracts. April 21, 2001 Letter from Commissioners re: *MECo's Default Service Pricing.* Although a twenty-four month power contract would be longer than those previously approved by the Department, it does not contravene any limitation in either Section 1B or in the Department's past decisions. The rational for eliminating the requirement for distribution companies to obtain bids for prices that are uniform for periods beyond one month has already been explained, pp. 24-26, *supra*, and the Department's authority to order that generation related costs be unbundled from distribution rates is well established. *Electric Industry Restructuring*, D.P.U. 95-30, pp. 39-43 (1995). Section 1B(d) clearly contemplates that the actual suppliers of Default Service power may be identified on customer bills and, as noted in the preceding section of these comments, is fully consistent with a requirement that Default Service suppliers be licensed retail suppliers. Finally, the DOER submits that the remaining elements of the DOER proposal -- that distribution companies be required to match individual customers and Default Service suppliers together with the latter serving as the "Power Supply Representative" and required to maintain and staff toll-free telephone lines for customer inquiries regarding Default Service pricing -- are well within the Department's authority under Section 1B as well as it overall supervisory authority.

IV. Conclusion

The DOER again commends the Department for undertaking this timely inquiry into how to modify Default Service to ensure that it is provided in a manner that is compatible with the development of an efficient competitive market in Massachusetts and the provision of competitive options to all customers. The DOER will review carefully comments filed by other interested parties and will address those comments and any issues rasied therein in its reply comments.

Respectfully submitted,

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(Attachment A filed electronically under separate Cover)

Attachment B: Customer Migration in June 2002
(Number of Customers)

		Residential		Small C&I		Medium & Large C&I	
		Customers	%	Customers	%	Customers	%
NSTAR	Standard Offer	646,337	68%	67,218	63%	20,173	61%
	Default Service	258,406	27%	27,942	26%	9,100	27%
	Market Supply	40,002	4%	10,811	10%	3,870	12%
	TOTAL	944,745	100%	105,971	100%	33,143	100%
FG&E	Standard Offer	14,734	63%	1,086	72%	1,172	74%
	Default Service	8,655	37%	415	27%	383	24%
	Market Supply	1	0%	14	1%	36	2%
	TOTAL	23,390	100%	1,515	100%	1,591	100%
GRID	Standard Offer	780,573	73%	73,490	60%	12,058	66%
	Default Service	280,017	26%	40,067	33%	3,104	17%
	Market Supply	8,486	1%	9,468	8%	3,147	17%
	TOTAL	1,069,076	100%	123,025	100%	18,309	100%
WMECO	Standard Offer	133,656	74%	12,146	68%	1,118	70%
	Default Service	44,629	25%	4,628	26%	210	13%
	Market Supply	1,232	1%	1,038	6%	274	17%
	TOTAL	179,517	100%	17,812	100%	1,602	100%